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UNCLAS SECTION 01 OF 03 HO CHI MINH CITY 001020

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SUBJECT: VIETNAM'S FIRST OPEN ECONOMIC ZONE - NO NUDE BEACHES YET

Summary

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¶1. In another example of the GVN channeling resources to the relatively poor central coast of the country, Vietnam's first "Open Economic Zone" has opened for business. More a vision than a reality, the zone is different from the many industrial parks and export processing zones scattered throughout the country in its size, scope and incentives for investors. It is also established and funded in part by the central government. Phase one of the project encompasses more than 150 square km, and it includes a free port, an airport, and plans for an industrial zone, residential, and tourism areas. So far, however, it is mostly sand. Chu Lai's possible saving grace is its airport. FedEx has indicated interest in the facility, which was built to accommodate B-52 bombers. Company officials state that it has almost an ideal location near major air routes as well as excellent weather conditions virtually every day of the year. For FedEx to consider this site as a regional hub, however, Vietnam would need to make significant reforms to customs regulations and procedures as well as allow 100% foreign ownership of their operation here. Fed Ex officials in HCMC did call the just-initialed bilateral Air Agreement "good news." Meanwhile, a successful Chu Lai OEZ could become an impetus for further reform and regional development, but sadly seems just as likely to end up another unrealized dream. End summary.

A vision for the future, but sand right now

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¶2. The Chu Lai Open Economic Zone is now open for business. Visitors who make their way out to the rather remote site, located about 2 hours south of Danang by car at the southern edge of Quang Nam Province, will have to use their imaginations to envision the extraordinary infrastructure development that has yet to occur. The site is enormous. Phase one takes up an area of about 150 square kilometers. Plans also call for a second, larger phase to begin development in 2015. According to these plans, the zone would run along virtually the entire coastline of the province, from the historic town of Hoi An in the north to the site of the Dung Quat oil refinery project in neighboring Quang Ngai Province in the south. The OEZ as it is today, however, runs only as far north as Tam Ky, the provincial capital, and is mostly sand. DPO and Econoff traveled to Chu Lai this summer and found virtually no infrastructure yet in place.

¶3. Chu Lai Open Economic Zone is Vietnam's first OEZ. According to local officials, it will offer the most liberal regulatory environment and incentives for investment and business activities in the country. The OEZ is different from the many industrial parks and export-processing zones scattered throughout Vietnam in its scope, size, and amount of incentives offered to investors. The centerpiece of the zone will be a free-trade zone with a free port. Foreign vessels and crews will be allowed entry to the port and free-trade zone and will not need go through customs and immigration procedures. Goods moving in and out of the free trade zone are not subject to tariffs or value added tax. The OEZ will also have an industrial park, residential zones and tourism areas.

¶4. Throughout the OEZ, investors will get the best tax breaks in the country. Enterprises operating in the OEZ will be exempt from corporate income tax for the first eight years after the enterprise has become profitable, then taxes will be applied at 50% of the standard rate for the next seven years. Individuals employed in the zone, both locals and foreigners, will also pay personal income tax at reduced rates. Land and infrastructure costs will be offered at concessionary rates. In addition, land leases will run for 70 years, the longest in Vietnam. Foreigners will be able to acquire property for residential as well as for industrial/commercial purposes. Officials state foreigners and Vietnamese investing and trading in the zone will receive the same treatment.

The port is small - so far

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¶5. For now, the port is small and still under construction. It can currently receive a 7,000 DWT vessel and expansion plans call for it to receive 10,000DWT ships next year. It could potentially be expanded to receive 30,000DWT ships at some point in the future. The length of the waterway is 4 km from buoy zero to the first wharf. The protected waterway leading up to the seaport has a channel 8-15 meters deep by 200 meters wide. Port officials state that the channel could be dredged up to 300 meters wide and 12-16 meters deep. The ship turning bay is 8 square km wide and the waiting bay is 7 square km. There are two wharves, one of which is currently being used by a Vietnam - Japanese joint venture to break down ships. This port is comparable in size to other small ports that dot the Vietnam coast.

Good weather at the airport

16. One real plus for the OEZ may be its airport. Currently operated by the military, it is scheduled to become a facility that will come under the joint jurisdiction of military and civilian authorities. The facility covers 2300 ha and is planned to expand to 4,000 ha in the future. Local officials claim that the airport is in good condition and note that it was built to accommodate B-52 bombers. FedEx representatives who have had access to the airport, however, state that it would have to be considered basically a green field site and would need to be substantially rebuilt. (Post note: The local press reports that the Vietnam Civil Aviation Administration is investing US\$6 million to upgrade the airport. In the first phase, \$4 million will be spent to build terminals and transport systems and install flight control equipment.) FedEx does point out, however, that the airport has an ideal location. Not only is it located on key regional air routes, Chu Lai has ideal weather for an airport and would face relatively few weather-related closings and delays.

17. FedEx has expressed interest in considering the site as an alternative to its current Southeast Asia hub in Subic Bay in the Philippines. For it to pursue its interest, however, FedEx has stated that it would need substantial reforms in Vietnamese customs regulations and procedures. In addition FedEx would seek 100% foreign ownership of its enterprise here. Even though local press has occasionally reported FedEx's interest in the site, there is so far little movement on any of these agenda items. FedEx has pointed out that making these changes would probably be worth the effort for Vietnam, since landing fees for just one large cargo plane currently run about US\$20,000. Fed Ex in Vietnam did however call the bilateral Air Services Agreement initialed in Hanoi on October 9 "good news." (Note: This agreement will give all-cargo carriers like FedEx the ability to operate from Vietnam with flexible routing rights and no limit on frequencies. End note.)

#### Support from the Top

18. The Chu Lai Open Economic Zone was approved by the Politburo in 1999 and finally approved by the Prime Minister this summer. According to Quang Nam officials, the project was able get approval because of significant political support in Hanoi. Mr. Le Xuan Trinh formally initiated the project in 1996. A native of Quang Nam, he headed the Office of Government from 1988 - 1996 and then that year moved to head the Management Board of Vietnam Industrial Parks and Export Processing Zones. He retired in 2001. The Party Secretary of Quang Nam, Mr. Vu Ngoc Hoang, was also a strong backer. His political influence was boosted considerably by the fact that his uncle was Vo Chi Cong, the former President of Vietnam. Other strong backers were Deputy PM Nguyen Tan Dung, who headed the steering committee for planning the OEZ, and Mr. Troung Tan Sang, Head of the Central Commission on Economic Affairs.

19. The idea for such an OEZ had clearly been around for some time in Vietnam. When Econoff was introduced to an elderly economist "who originally proposed the idea of an open economic zone," Econoff asked when he first raised the idea. A wry smile crossed the old mans face and with a measure of satisfaction he replied "1954."

#### Helping out the Central Coast

110. This project, like many others, is designed to give a boost to the development prospects of the central coast. With a per capita GDP of USD\$230, Quang Nam Province is poor. Even though the province boasts two UNESCO-designated world heritage sites and 120 kilometers of coastline, it has little which resembles the more prosperous Ho Chi Minh City area. It is located just south of Danang, and split from that province in 1999. According GVN measures, 20% of its population of 1.4 million lives below the poverty line and more than 30% of children under the age of 5 are malnourished. Last year the province exported about US\$36.6 million worth of goods, most of which was very low value added goods and commodities - agricultural goods and seafood, clothing and footwear, and sand. Because of the relative poverty of this region, the central government has tried to commit resources to help aid development. The Dung Quat oil refinery project, for example, is located just south of Chu Lai.

#### Is this Shenzhen?

111. Although Chu Lai has already attracted some investment, it is still early days. It will be hard pressed to successfully sell to the world a tourism zone located virtually in the front yard of an industrial park and near an oil refinery. And without infrastructure, regardless of the price, attracting business will be rough going. Companies will find it difficult to attract expatriate management and technical staff. When DPO and Econoff visited the site, local officials were insistent that the project would succeed because "the Prime Minister has given his support." The support they need, however, is support from businesses willing to make sizable long-term investments. They also need to deal with what one Chu Lai official dubbed their biggest challenge -

"the capacity of local officials." One speaker at a seminar introducing Chu Lai in HCMC suggested that the model for the project was Shenzhen, China, the wildly successful open economic area that Deng Xiaoping established along the border with Hong Kong. If only Chu Lai shared a border with Hong Kong.

¶12. With that said, however, some investors have shown interest. According to local officials, a Taiwanese and a French firm are pursuing a tourism project. A number of Korean firms have also looked into the site. Two consulting firms in HCMC have also informed Econoff that they have talked with Korean clients interested in possibly building in Chu Lai because they have taken note of the low cost land and tax breaks.

¶13. Some potential investors have expressed interest in learning just how open Chu Lai will be for different businesses. The Party Secretary of the Province, who looks something like a rumpled

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professor, stood up at the seminar in Ho Chi Minh City publicizing the establishment of the zone and stated that "all business activity not specifically prohibited by Vietnamese law would be permitted in Chu Lai." That brought several serious questions about the possibility of opening banking and other financial services firms as well as casinos in the zone. One member of the audience drew the most attention when he asked if nude beaches would be permitted. The party secretary smiled, and replied that because of the current cultural environment in Vietnam, such a suggestion would be best deferred for review at some time in the future. The room erupted in laughter.

Comment

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¶14. The future of the Chu Lai Open Economic Zone is no laughing matter, however. The central government is committing real resources into what will either be a large white elephant or a potential laboratory for further economic opening and an engine for regional growth. It will take more than good humor and central government support to attract the level of investment needed for this place to take off. Even with its low cost labor and land, many other locations will still likely be more attractive for most investors. Its best hope is probably developing the airport, but first Vietnam will have to get its customs act together and make other major reforms.

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